

REPORT OF EXAMINATION

OF THE

MARKET CONDUCT AFFAIRS

OF

UNION NATIONAL FIRE INSURANCE CO

BATON ROUGE, LOUISIANA

AS OF

December 31, 2003

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May 26, 2004

Honorable Robert Wooley
Commissioner of Insurance
P O Box 94214
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Sir:

Pursuant to your instructions and authorization, and in compliance with statutory provisions, a limited market conduct examination has been made of the affairs of the

UNION NATIONAL FIRE INSURANCE COMPANY

BATON ROUGE, LOUISIANA

as of December 31, 2003 and the report of examination is herewith submitted.

FOREWORD

In accordance with **LSA-R.S. 22:1301 D.**, a market conduct examination was conducted on the activities of Union National Fire Insurance Company from January 1, 2000 through December 31, 2003. The examination was performed by test and all tests applied are included in this report.

PURPOSE AND SCOPE OF MARKET CONDUCT EXAMINATION

The market conduct examination of Union National Fire Insurance Company, hereinafter referred to as ("Company"), was a limited routine market conduct examination authorized by the Louisiana Department of Insurance ("LDOP") or ("Department"). Limited, in that not all examination procedures recommended by the National Association of Insurance Commissioners were performed.

The examination included, but was not limited to, the following areas of the Company's operation:

- Company Overview,
- Complaints,
- Producer Licensing,
- Marketing and Sales,
- Underwriting and Rating,
- Claims and
- Consumer Privacy Policy.

The purpose of this examination was to review compliance by the Company with Louisiana Insurance Laws, Regulations, Directives and the National Association of Insurance Commissioners ("NAIC") Guidelines. The NAIC Guidelines set the standard of conduct for a property and casualty insurer and promote a program of fair treatment of policyholders. Portions of the NAIC Market Conduct Examiner's Handbook, Volume I were used as a measure of compliance.

The ACL Program, a data manipulation program, provided by the Department was utilized in this examination. Samplings were utilized to test the Company's records and procedures for statutory compliance. The ACL Program was used, when possible, to automatically generate a random sampling of data records. "Random" is a theoretical concept meaning that all items in a population or file (before selection) have an equal chance of appearing in the sampling. In instances in which ACL was not used, a systematic (sequential) sampling of certain company record listings or a manual random sampling was performed.

Generally a random or systematic sampling size of sixty (60) records will be selected for review. A minimum confidence level of ninety-five percent (95%) with a maximum error rate of five percent (5%) will be used for all samples. Based on a review of the sampling's error rate, additional samplings may be required.

COMPANY OVERVIEW

COMPANY HISTORY

The Company was incorporated as an industrial fire insurance company under the laws of state of Louisiana on March 21, 1960. It received its Louisiana Certificate of Authority on April 6, 1960 and commenced business on May 23, 1960.

Union National Fire Insurance Company is licensed to transact business in Alabama, Arkansas, Louisiana, Mississippi, Oklahoma, Tennessee and Texas. During the period under examination the Company marketed only in Louisiana and Mississippi.

On March 1, 1991, the Company amended its certificate of authority to add accident and health insurance to its authorized lines of business. On April 26, 2002, the Company amended its certificate of authority to add burglary coverage to its authorized lines of business.

Union National Life Insurance Company (“UNLIC”) owns one hundred percent (100%) of the shares of Union National Fire Insurance Company.

TERRITORY AND PLAN OF OPERATIONS

The Company is licensed in the following states:

Alabama	Arkansas
Louisiana	Mississippi
Oklahoma	Tennessee
Texas	

The Company marketed home service fire and extended coverage insurance in Louisiana and Mississippi during the period under examination.

The Company's annual statements for the period under examination reflected the following Louisiana written premium:

<u>YEAR</u>	<u>PREMIUMS WRITTEN*</u>
2001	\$ 9,861,949
2002	10,787,589
2003	11,701,189

- Schedule T of the Annual Statements

PARENT, SUBSIDIARIES AND AFFILIATED COMPANIES

The Company is a wholly owned subsidiary of Union National Life Insurance Company ("Union National Life"), domiciled in the state of Louisiana. Union National Life is a wholly owned subsidiary of United Insurance Company of America ("United"), domiciled in the state of Illinois. United is a wholly owned subsidiary of Unitrin, Inc., an insurance holding company domiciled in the state of Delaware.

The Company's annual statement depicts an organizational chart of all insurer members under this holding company system.

ADMINISTRATIVE SERVICES AGREEMENT

Under an agreement dated October 31, 1989, between the Company and Union National Life, the parent agreed to perform sales and servicing of the Company's monthly premium fire insurance policies through the parent's agents licensed in Louisiana and Mississippi.

In addition to production of business, Union National Life agreed to perform certain administrative services including accounting and reporting, investigation and settlement of claims, appointment of agents, actuarial and underwriting services, rating policies, data processing, legal and executive services.

The fee for these services is based on the administrative costs incurred by Union National Life. As a result of this agreement, the Company has no employees.

RECOMMENDATIONS FROM PRIOR EXAMINATION REPORTS

There were no market conduct issues from the previous Louisianan Financial Examination Report dated as of December 31, 1999, that required any follow-up in this report.

COMPLAINTS REVIEW

This review was conducted in accordance with the provisions of Louisiana Revised Statute 22:1214 **Methods, acts, and practices which are defined herein as unfair or deceptive. Specifically 22:1214 (17), which states as follows:**

“Failure to maintain adequate complaint handling procedures. Failure of any insurer to maintain a complete record of all the complaints that it received since the date of its last examination. This record shall indicate the total number of complaints, their classification by line of insurance, the nature of each complaint, the disposition of each complaint, and the time it took to process each complaint. For purposes of this Paragraph, “complaint” shall mean any written communication primarily expressing a grievance received by the insurer from the Department of Insurance.”

The Company provided complaint procedures which appeared adequate for the proper recording and timely processing of complaints. During the examination the Company provided a complaint register for the three (3)-year period, which was in compliance with the above Louisiana Statute. It should be noted the Department recorded only fifteen (15) complaints filed against the Company during the period under examination.

PRODUCER REVIEW

The Company has twelve (12) district offices well distributed in Louisiana, with each district staffed by approximately thirty (30) producers who service the company's policyholders.

The producer is provided a hand held computer whereby he or she can immediately enter the premium collected from each policyholder. The utilization of the hand held computer allows for more accurate and timely reporting of premium collections.

With the installation of modems in 2001, the producer transmits home service premium collections daily to the Company and then deposits premiums collected into the Company's depository account. Producers must settle their accounts at the end of each week.

A systemic sampling of forty-eight (48) producers was selected from the Company's February 26, 2004 listing of approximately four hundred and thirty-eight (438) active producer appointments in order to verify that producers were properly appointed with the Department. One (1) exception was noted: a producer on disability was not removed from the Company's producer listing when the appointment termination was submitted to the Department.

A judgmental sampling of thirty-five (35) producers were selected from the Department's listing of appointments based on hiring and termination dates. This review indicated that the Company timely appoints new recruits. However, two (2) terminated producers appeared to be dismissed for causes addressed in **LSA-R.S. 22:1142** but the terminated appointments submitted to the Department were not in compliance with **LSA-**

R.S. 22:1145 B. As a result of this finding a complete review was performed on terminated producers during the period under examination.

The Company was requested to provide a listing of all producers terminated during the period under examination. After a review of producer terminations provided by the Company and numerous discussions with the Company, it was determined that fifteen (15) producers had been terminated for causes addressed in **LSA-R.S. 22:1142** (primarily premium shortages) in which the appointments of terminations submitted to the Department was not in compliance with **LSA-R.S. 22:1145 B** which states in pertinent part as follows:

“An insurer or authorized representative of the insurer that terminates the appointment, employment contract, or other insurance business relationship with a producer shall notify the commissioner of insurance within fifteen days following the effective date of the termination, in a manner prescribed by the commissioner, if the reason for termination is one of the reasons set forth in R. S. 22:1142...”

The Company was advised of the finding of fifteen (15) producers that were not terminated in accordance with **LSA-R.S. 22:1145 B.** The Company responded that three (3) of the fifteen (15) producers were initially terminated for violation of **LSA-R.S. 22:1142.** After lengthy Company audits, the remaining twelve (12) producers were determined to be in violation of **LSA-R.S. 22:1142.** The Company did not timely terminate the fifteen (15) producers in accordance with **LSA-R.S. 22:1145 B.**

In addition, the Company responded by implementing a procedure to ensure compliance with **LSA R. S. 22:1142.** If full documentation cannot be included with the Appointment Cancellation Notice provided to the Department of Insurance, the following note will be typed on the appointment cancellation notice, ***“Terminated for cause under R. S. 22:1142. Under investigation, documentation to follow.”***

A copy of this notification to the Department will also be provided to the terminated producer by certified mail at his or her last known address. The Company will then complete an audit of the producer's debit within sixty (60) days and provide any additional material findings to the Department's Fraud Division.

If after termination of an appointment for cause for any reason *not* addressed in **LSA-R.S. 22:1142**, the Company detects such causes, it will notify the Fraud Division of the Department within fifteen (15) days of the discovery by letter with full documentation. If full documentation cannot be provided at that time, it will be provided within sixty (60) days after a complete audit of the producer's debit.

The Company requires prospective employees and producers to take a drug-screening test. Also, applicants must certify that he or she has not been convicted of a criminal felony nor any offense under 18 U. S. C. Section 1033. Finally, a routine inquiry is made of all applicants, which provides information on character, mode of living, criminal records and credit history.

The Company's hiring procedures for producers and employees appear to be in compliance with **Louisiana Bulletin #99-01** dated June 1, 1999 titled "Consent for Prohibited Person to engage in Insurance Business, 18 United States Code, Sections 1033 and 1034".

MARKETING AND SALES REVIEW

The Company only advertises for name recognition. Brochures designed as handouts were reviewed without exception.

During the period under examination, the Company had no electronic mail communication with its producers. The Company's producers are provided a training

manual, ***FIRE STEP***, which includes marketing and product knowledge of its fire coverages. The producer is also given instructions on Union National's ***Principles and Code of Ethical Market Conduct, Market Conduct Rules*** and the ***Unfair Trade Practices Act***.

UNDERWRITING AND RATING REVIEW

Under an administrative Service Agreement with Union National Life, the Company is furnished the facilities and personnel for the sale and service of its fire policies. All of the policies written are one hundred percent (100%) quota share reinsured by Trinity Universal Insurance Company, an affiliate.

Applications on both dwelling and contents are submitted to Career Agency Insurance Service ("CAIS") in St. Louis, Missouri for underwriting and issue. CAIS is a service center developed by Unitrin, Inc. to consolidate some insurance functions of the Company such as policyholder service, new business, underwriting and claims in order to increase efficiency and cost effectiveness.

The Company provided a CD containing all insurance policies issued in 2001, 2002, and 2003 covering dwellings and contents (including mobile home contents) on Louisiana residents. ACL was utilized to select a random sampling of sixty (60) policies.

In response to this ACL sampling the Company provided a CD of sixty (60) scanned images of applications and related documents. Sampled applications were complete and signed and dated by the applicant and the writing agent. A time study indicated that underwriting issued new policies in an average of five (5) days. The Company could not locate two (2) policy records from the sampling.

From the above sampling of sixty (60) scanned images approximately twenty (20) applications were reviewed to verify rating with the Company's field rating manual. This review was performed without exception.

The Company was requested to provide a listing of policies that either lapsed or were non-renewed during the period under examination. Although the Company did not routinely maintain this data, a program was developed to provide the 2003 activity. Because the Company indicated that the retrieval of the 2003 activity was labor intensive, the Company was not asked to provide listings of policies lapsed or non-renewed for 2001 and 2002.

A judgmental sampling of fifty (50) policies was manually selected from the 2003 listing of policies lapsed or non-renewed. The sampling consisted of death lapses, claims with total loss, non-renewals due to vacant status or property in need of repair. The Company's reason for non-renewal and date of notification to the insured was in accordance with applicable statutes, rules and regulations.

The Company was unable to provide a listing of rejected applications for the period under examination. Failure to maintain the requested underwriting records is not in compliance with **R.S. 22:1214. Methods, acts and practices, which are defined herein as unfair or deceptive;** specifically **R.S. 22:1214 (16)** which states as follows:

“Failure to maintain marketing and performance records. Failure of an insurer to maintain its books, records, documents and other business records in such an order that data regarding complaints, claims, rating, underwriting, and marketing are accessible and retrievable for examination by the insurance commissioner. Data for at least the current calendar year and the two preceding years shall be maintained.”

When advised of this exception the Company responded that all rejected applications are microfilmed and retained by the Company. Since the policy was never

issued and the data was not retained in the company's Life 70 System, a listing of this activity could not be provided.

To correct this exception the Company stated it would immediately implement a corrective action by manually recording and logging all rejected applications on a separate form, which will include the insured's name, district, policy number, date notice sent, reason for rejection and state of residence.

After implementing the manual procedure, the Company stated it would begin to design a program so that rejected non-bound applications and insured information can be captured and retained on its Life 70 System. Once implemented the Company will be able to provide computer reports of all rejected applications data.

A general review was performed of the policy forms approved by the Department during the period under examination. This review was performed without exception.

CLAIMS REVIEW

The twelve (12) district offices located throughout Louisiana are responsible for providing claim services. The district office conducts the initial inspection with the insured, takes photographs and secures fire and/or police reports. Field adjusters are also used for extensive claims review.

The district office assists the policyholder in submitting the claim, but the adjudication and authority to pay the claim resides with the Baton Rouge Claims Office. While the Baton Rouge Claims Office maintains the original claim file, a copy is provided to the district office involved with the claim process.

The Company acknowledged that its claim numbers are unique but not in sequential order. There are two (2) reasons for gaps in the sequencing of the claim number during claim processing. First, the Company uses the same claim system for its Mississippi Operation, which would cause gaps in claim numbers. Second, any adjustment claim activity on a prior year claim will create a gap in the current year claim activity because the original claim number is used.

The Company provided a CD containing 2003 paid claims, claims closed without payment and denied claims for fire and extended coverage insurance on dwellings and/or contents. ACL was utilized to extract random samplings from these claim records.

After the 2003 paid claims total was reconciled with the 2003 annual statement total, ACL was utilized to select a random sampling of sixty (60) paid claims. A review of the paid claims revealed that the claims were paid timely in accordance with policy provision, statutes and regulations. A time study showed that paid claims from the sampling were paid in an average of four (4) days.

It should be noted that the paid claims sampling, through examiner error, consisted of fifteen (15) denied claims and forty-five (45) paid claims. Since the various district offices provided the sampled claims and the forty-five (45) paid claims were reviewed without exception, it was deemed unnecessary to select an additional sampling of paid claims.

ACL was utilized to select a random sampling of sixty (60) denied claims for review. The Company was unable to provide documentation for one (1) claim from the sampling. A review of the fifty-nine (59) denied claims and the previous fifteen (15) denied claims from the paid claim sampling indicated denied claims were processed in

accordance with policy provisions, statutes, and regulations. A time study showed that denied claims were processed in an average of ten (10) days (received date of claim minus denial date of claim).

ACL was utilized to select a random sampling of sixty (60) claims closed without payment. A review of this sampling revealed the following: some claims submitted by the insured were not adequately documented; the insured elected not to continue the claim process, the amount of the loss was less than the policy deductible, or the loss was not a covered peril.

The Company gave the insured ample time to provide necessary documentation before advising the insured by letter the claim file was closed. Seven (7) claims were reopened and paid after the insured submitted adequate documentation.

The Company's claim files were well documented. The date the claim was received by the district claims office was routinely stamped on the claim form.

The individual claim files that were reviewed during this examination did not contain any documentation on the reserving of the claim. The Company responded that reserves were based on an eighteen (18)-month survey of claims by peril.

ACL was utilized to generate the following time study of all paid claims for 2003.

RANGE	COUNT	← %	% →	DOLLAR AMT
0 TO 30 DAYS	1,819	60.88%	53.39	\$ 2,755,734
31 TO 60 DAYS	561	18.78	31.97	1,650,400
61 TO 91 DAYS	295	9.87	6.29	324,704
> 91 DAYS	313	10.48	8.35	431,064
TOTALS	2,988	100.00%	100.00%	\$ 5,161,902

The ACL time study indicated that approximately eighty percent (80%) of the number of claims and eighty-five percent (85%) of the dollar amount of claims were paid

within sixty (60) days from the date the claim was received. This time study was based on the date the claim was received and the date the claim was paid.

In the time study of the forty-five (45) paid claims previously addressed, the examiner was able to determine a “clean date”, which in many cases was a later date than the date the Company was notified of a claim. A clean date for purposes of this report is defined as the date in which the Company had all documents necessary to determine the claim liability and to make payment. This approach resulted a better turnaround time for claim payments than the ACL time study of all claims paid in 2003.

The Company was advised of the importance of determining and recording a “clean date” in its claim processing, such a date would provide a more accurate date for future ACL time studies.

Finally, in order to identify claim fraud the Company utilizes the services of the National Insurance Crime Bureau and the National Association of Independent Insurers, which provides indicators of casualty fraud detection and publications on detecting red flags in potential claim fraud.

CONSUMER PRIVACY POLICY REVIEW

A review of the Company’s Privacy Procedures, which govern the privacy of consumer financial information, is in compliance with the Louisiana Department of Insurance Regulation 76 / *PRIVACY OF CONSUMER FINANCIAL INFORMATION*.

COMMENTS AND RECOMMENDATIONS

It should be noted this was the first routine market conduct examination of the Company.

PRODUCER REVIEW

The Company was advised of the finding of fifteen (15) producers that were not terminated in accordance with LSA-R.S. 22:1145 B. The Company responded that three (3) of the fifteen (15) producers were initially terminated for violation of LSA-R.S. 22:1142. After lengthy Company audits, the remaining twelve (12) producers were determined to be in violation of LSA-R.S. 22:1142. The Company did not timely terminate the fifteen (15) producers in accordance with LSA-R.S. 22:1145 B which states in pertinent part as follows:

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UNDERWRITING REVIEW

The Company was unable to provide a listing of rejected applications for the period under examination. Failure to maintain the requested underwriting records is not in compliance with **R.S. 22:1214. Methods, acts and practices, which are defined herein as unfair or deceptive;** specifically **R.S. 22:1214 (16)** which states as follows:

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After implementing the manual procedure, the Company stated it would begin to design a program so that rejected non-bound applications and insured information can be captured and retained on its Life 70 System. Once implemented, the Company will be able to provide computer reports of all rejected applications data.

CONCLUSION

I, Richard A. Spong, do solemnly swear and affirm that I am an examiner for the Commissioner of Insurance of the State of Louisiana and that as such I was assigned to conduct an examination of the market conduct activities of

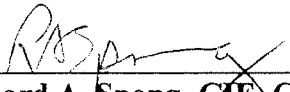
UNION NATIONAL FIRE INSURANCE COMPANY

BATON ROUGE, LOUISIANA

That I made such examination and the above and foregoing is a true and correct copy of my report of such company and the same is true and correct to the best of my knowledge, information and belief

The undersigned appreciated the courteous cooperation of the Company's Officers and Employees.

Respectfully submitted,


Richard A. Spong, CIE, CFE
Louisiana Department of Insurance